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SUBJECT: RESULTS OF EDRC ANNUAL REVIEW OF GERMANY,
APRIL 16

REFS: (A) STATE 86463

(B) USOECD 9301

(C) OECD DOCUMENT EDR(75)8

1. SUMMARY. EDRC ANNUAL REVIEW OF GERMANY WAS LARGELY UNINFORMATIVE AS GERMAN DELEGATION (LED BY DAASE OF ECONOMICS MINISTRY) PARRIED EDRC QUESTIONS AND OBFUSCATED POLICY ISSUES AND PROSPECTS. GERMANS ATTEMPTED UNSUCCESSFULLY TO ENLIST EDRC SUPPORT IN DESCRIBING OUTLOOK IN MORE OPTIMISTIC LIGHT THAN SEEMED JUSTIFIED BY OBJECTIVE EVIDENCE, OR AVOWED PURPOSE OF INSPIRING GREATER CONFIDENCE AT HOME IN GERMAN PROSPECTS FOR RAPID RECOVERY. GERMAN DEL REJECTED SECRETARIAT "BIAS" TOWARD FURTHER STIMULATION OF ECONOMY IN FAVOR OF CONTINUED "WAIT AND SEE" APPROACH. HE AGREED, HOWEVER, THAT OFFICIAL GERMAN FORECAST OF 2 PERCENT REAL GNP GROWTH IN 1975 WAS NO LONGER LIKELY TO BE ACHIEVED AFTER
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SLOW START TO RECOVERY IN FIRST QUARTER. GERMANS DID

NOT DENY SECRETARIAT CONCLUSION THAT PUBLIC SECTOR DEFICITS MAY BE NECESSARY MEDIUM-TERM FEATURE OF GERMAN INTER-SECTORAL FINANCIAL BALANCES, ALTHOUGH STRESSING THAT FINANCIAL DEFICIT EXPECTED IN 1975 WAS TOO HIGH AT 4.5 PERCENT OF GNP. ON BALANCE OF PAYMENTS FOR 1975, GERMANS ANTICIPATE MODEST DECLINE IN CURRENT ACCOUNT SURPLUS DUE TO DETERIORATION OF INVISIBLES, AND THEY EXPECT LARGE CAPITAL OUTFLOWS TO CONTINUE AS EVIDENCED BY MOVEMENTS IN FIRST QUARTER OF 1975. END SUMMARY.

2. TONE OF MEETING: EDRC REVIEW OF GERMANY WAS REMARKABLE IF ONLY FOR PERSISTENCE WITH WHICH GERMAN DELEGATION SOUGHT TO EVADE EDRC QUESTIONS AND GIVE MINIMUM INFORMATION ON POLICIES AND PROSPECTS. VERY FEW OF QUESTIONS POSED BY U.S. AND ITALIAN EXAMINERS, AS WELL AS OTHER EDRC MEMBERS, WERE ANSWERED ADEQUATELY. APPARENTLY DELIBERATE EFFORT AT OBFUSCATION MAY HAVE BEEN DUE TO HIGH-LEVEL SENSITIVITY ABOUT POSSIBLE LEAKS FROM EDRC PRIOR TO CRUCIAL MAY 4 REGIONAL ELECTIONS. IN ANY CASE, GERMANS TOOK POSITION THAT SECRETARIAT PAPER (WHICH IS NOT SCHEDULED FOR PUBLICATION UNTIL JUNE) SHOULD AVOID EXPRESSING DOUBTS REGARDING TIMING OF EXPECTED UPSWING, SINCE THIS WOULD INFLUENCE INVESTMENT DECISIONS AND POSSIBLY CONTRIBUTE TO DELAY IN RECOVERY. IT WAS BETTER TO EXUDE CONFIDENCE IN ORDER TO BOLSTER PSYCHOLOGICAL CLIMATE AND ENCOURAGE WOULD-BE INVESTORS. SECRETARIAT REJECTED THIS SUGGESTION THAT AN OECD REPORT SHOULD BE DRAFTED TO CONTRIBUTE TO A CAMPAIGN TO CREATE CONFIDENCE, AND CHAIRMAN TRIED HARD TO CONVINCE GERMANS TO PARTICIPATE IN FRANK AND THOROUGH ANALYSIS OF CURRENT ECONOMIC SITUATION. HE NOTED THAT SECRETARIAT DRAFTS AND EDRC DISCUSSIONS MUST BE STRAIGHTFORWARD ASSESSMENTS OF SITUATION IF EDRC MEMBERS AND COUNTRY CONCERNED ARE TO BENEFIT FROM EXAMINATION, AND ONLY LATER WOULD IT BE APPROPRIATE TO CONSIDER PROBLEMS OF POLITICAL NATURE AND DECIDE WHAT TO PUBLISH.

3. GENERAL ECONOMIC OUTLOOK: GERMANS, SECRETARIAT AND COMMITTEE SHADOW-BOXED AROUND QUESTION OF TIMING AND STRENGTH OF EXPECTED UPTURN, AND WHETHER PRESENT POLICY LIMITED OFFICIAL USE

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STANCE WAS ADEQUATE TO ACCOMPLISH STATED GERMAN OBJECTIVES. GERMAN DELEGATION INDICATED CONVICTION THAT UPSWING JUST AROUND CORNER, AND CITED (A) IMPROVEMENT IN DOMESTIC ORDERS; (B) PROSPECT OF INCREASED DEMAND FOR INVESTMENT GOODS DUE TO EXPIRATION OF INVESTMENT BONUS IN JUNE; (C) EXPANSIONARY EFFECTS OF STOCKBUILDING IN SECOND HALF (AFTER DECLINE IN FIRST HALF); (D) IMPROVED EXPORT TRENDS; AND MOST IMPORTANTLY, (E) EXPECTED STRONG

INCREASE IN PRIVATE CONSUMPTION. GERMANS THOUGHT UNEMPLOYMENT CAN BE KEPT WITHIN 3 PERCENT LEVEL IN VIEW OF EXPECTED DECLINE IN LABOR FORCE BY 2 PERCENT (ASSUMING NET DECREASE OF 250,000 FOREIGN WORKERS AND LOWER PARTICIPATION RATES). CONSUMER PRICES MAY WELL RISE ONLY 5.5 PERCENT IN 1975, ALTHOUGH GNP DEFLATOR EXPECTED TO INCREASE AT 7 PERCENT RATE.

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4. SECRETARIAT AGREED THAT UPSWING WAS COMING, BUT POINTED OUT THAT INDUSTRIAL PRODUCTION INDEX STILL DECLINING IN FIRST QUARTER, AND RECOVERY WOULD PROBABLY BE DELAYED BY AT LEAST ONE QUARTER. RESULT WOULD BE DOWNWARD REVISION IN SECRETARIAT ESTIMATES OF GNP FROM ONE PERCENT TO ZERO GROWTH IN 1975, AND POSSIBLE REVISION UPWARD IN UNEMPLOYMENT FIGURES. U.S. DEL ASKED IF GERMANS STILL ANTICIPATED 2 PERCENT GROWTH OF GNP IN 1975 AND WAS TOLD THAT THIS WAS TARGET FIGURE WHICH COULD NO LONGER REALISTICALLY BE ACHIEVED. IN FACT,

GERMANS NOTED THAT EVEN ONE PERCENT INCREASE WOULD ASSUME FAIRLY STEEP GROWTH AT 3 PERCENT ANNUAL RATE "IN LATTER PART OF YEAR." OTHER EDRC DELS (ITALY, SWEDEN, JAPAN, BELGIUM, U.K.) ALL EXPRESSED DOUBTS THAT UPSWING WOULD COME AS EARLY AS GERMANS EXPECTED AND SHOWED CONCERN FOR EFFECTS ON DEMAND FOR IMPORTS FROM NEIGHBORING COUNTRIES.

5. POLICY STANCE: GERMANS MADE CLEAR FROM OUTSET THAT LIMITED OFFICIAL USE

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THEY COULD NOT ACCEPT IMPLICIT ASSUMPTION IN DRAFT SURVEY THAT FURTHER STIMULUS TO ECONOMY WOULD BE NECESSARY TO SUSTAIN EXPECTED UPSWING. GERMAN AUTHORITIES WILL WAIT AND SEE RESULTS OF MEASURES TAKEN IN DECEMBER BEFORE CONSIDERING FURTHER ACTION. SECRETARIAT AGREED WITH WAIT-AND-SEE APPROACH, BUT QUESTIONED HOW LONG GERMANS SHOULD WAIT, GIVEN DANGER THAT DELAY IN RECOVERY MIGHT LEAD TO FURTHER EXPORT BOOM AND PROLONG WEAKNESS OF GERMAN DEMAND FOR DOMESTIC AND FOREIGN GOODS. U.S. DEL SUGGESTED THAT GERMANS SHOULD BE GIVEN BENEFIT OF DOUBT BUT EXPRESSED HOPE FRG WOULD BE READY TO REVIEW POLICIES SHOULD RECOVERY BE SLOWER THAN ANTICIPATED. OTHER EDRC DELS (SEE PARA 4 ABOVE) SUPPORTED SECRETARIAT BY EXPRESSING DOUBT THAT PRESENT MEASURES WOULD BE SUFFICIENT TO SUSTAIN RECOVERY AND URGING GERMANS NOT TO WAIT-AND-SEE TOO LONG. JAPANESE AND BRITISH DELS SUGGESTED THAT CURRENT GNP GROWTH TARGET OF 2 PERCENT WAS RATHER MODEST CONSIDERING THAT (1) THERE IS NO BALANCE-OF-PAYMENTS CONSTRAINT; (2) WAGE NEGOTIATIONS HAVE ALREADY BEEN CONCLUDED SO THERE WOULD BE NO FURTHER RISK OF WAGE PRESSURES; (3) UNUTILIZED CAPACITY IS INCREASING SO THAT ADDITIONAL DEMAND PRESSURES COULD BE ACCOMMODATED, AND (4) THERE IS STILL ROOM FOR CAPITAL MARKETS TO ABSORB FURTHER BUDGET DEFICITS. GERMANS DID NOT COMMENT.

6. POLICY MEASURES: GERMANS WERE UNHAPPY WITH SECRETARIAT CONCLUSION THAT BUDGET DEFICITS IN 1975 WOULD CONTAIN LITTLE ADDITIONAL STIMULUS OVER 1974 IN TERMS OF VOLUME IMPACT ON GNP. (THIS IS CONTRARY TO WHAT GERMANS HAVE BEEN CLAIMING IN EPC AND ELSEWHERE RECENTLY.) SECRETARIAT AGREED, HOWEVER, THAT SIZE OF PUBLIC SECTOR FINANCIAL DEFICIT WAS TOO LARGE AND SHOULD BE REDUCED BELOW 4.5 PERCENT OF GNP. U.S. DEL ASKED IF PUBLIC SECTOR DEFICIT WOULD BE EVEN LARGER THAN DM 55 BILLION PROJECTED AT 2 PERCENT REAL GROWTH OF GNP, SINCE GNP TARGET NOW UNLIKELY TO BE ACHIEVED. GERMANS REPLIED THAT THERE WOULD BE LITTLE IMPACT ON TAX REVENUES SINCE GNP DEFLATOR WOULD BE SLIGHTLY HIGHER AT 7 PER-

CENT AND WOULD LEAVE NOMINAL GNP RELATIVELY UNCHANGED.
HOWEVER, THEY MENTIONED THAT TAXES MIGHT HAVE TO BE
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"ADJUSTED" IN VIEW OF VERY LARGE BUDGET DEFICIT. (THIS
WOULD TEND TO COUNTER STIMULATING EFFECTS OF TAX
REFORM, WHICH GERMANS SAY WILL NOT BE FELT BEFORE EARLY
1976.)

7. ITALIANS QUESTIONED IMPACT OF DEFICIT FINANCING ON
CAPITAL MARKETS AND POSSIBLE INCREASE IN INTEREST RATES,
WHICH THEY NOTED WOULD STRENGTHEN DM AND ENCOURAGE CAPI-
TAL INFLOWS. OTHERS MENTIONED POSSIBLE CONSTRAINT ON
FINANCING, GIVEN GERMAN'S LIMIT OF 8 PERCENT GROWTH OF
MONETARY STOCK. GERMANS SAID 8 PERCENT WAS TARGET
FIGURE AND THEY WOULD FOLLOW FLEXIBLE POLICY. THEY
NOTED THAT 25 PERCENT OF EXPECTED DM 30 BILLION FEDERAL
DEFICIT IN 1975 HAD ALREADY BEEN FINANCED IN FIRST TWO
MONTHS OF THIS YEAR. A SHIFT TO SHORT-TERM FINANCING
WOULD HELP AVOID FUTURE PRESSURE ON LONG-TERM INTEREST
RATES.

8. MEDIUM-TERM FINANCIAL BALANCES: GERMANS QUESTIONED
SECRETARIAT VIEW THAT IT WOULD BE HEALTHY FOR PUBLIC
SECTOR FINANCIAL DEFICIT TO RISE OVER MEDIUM TERM. THEY
NOTED THAT LONG-TERM POTENTIAL GROWTH RATE IS EXPECTED
TO FALL FROM 4.5 PERCENT IN 1960'S TO 3.5 PERCENT IN

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1970'S, WHILE LABOR FORCE WOULD SOON BEGIN TO RISE AGAIN. THUS, GERMANS SEE NEED FOR INCREASING FINANCIAL DEFICIT OF BUSINESS SECTOR IN ORDER TO ENCOURAGE INVESTMENT. SECRETARIAT AGREED THAT PUBLIC SECTOR DEFICITS SHOULD BE REDUCED IN SHORT TERM TO PERMIT INCREASE IN BUSINESS SECTOR DEFICIT, AND SUGGESTED THIS MIGHT BE ACHIEVED BY REDUCING BUSINESS TAXES. HOWEVER, MEDIUM-TERM PUBLIC SECTOR DEFICITS WOULD BE USEFUL COUNTER-CYCLICAL STABILIZATION DEVICE (WE UNDERSTAND GERMANS IN POST-MEETING CONSULTATIONS AGREED THAT SOME INCREASE IN PUBLIC SECTOR DEFICITS MIGHT BE USEFUL IN MEDIUM TERM.)

9. BALANCE OF PAYMENTS: GERMANS AND EDRC DELS NOTED RELATIVE ABSENCE OF DISCUSSION IN REFDOC OF B/P ISSUES. SECRETARIAT REPLIED THAT EXTERNAL SECTOR HAD BEEN EXTENSIVELY DISCUSSED IN LAST YEAR'S SURVEY, BUT AGREED THEY WOULD AMPLIFY TEXT IN THIS RESPECT. GERMANS EXPECT MODEST DECREASE IN CURRENT ACCOUNT SURPLUS IN 1975 DUE TO DETERIORATION OF INVISIBLES BALANCE. THEY WELCOMED U.S. LIMITED OFFICIAL USE

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DEL'S QUESTION REGARDING PROSPECTS FOR FINANCING SURPLUS VIA CAPITAL OUTFLOWS, SAYING PROSPECTS FOR CAPITAL EXPORTS WERE FAVORABLE. GERMANS POINTED TO ALMOST DM 2 BILLION SUCH FLOWS INTO FOREIGN SECURITIES DURING FIRST TWO MONTHS OF 1975, AND ADDITIONAL DM 2.8 BILLION IN FOREIGN EXCHANGE INTERVENTION TO MAINTAIN STABILITY OF DM EXCHANGE RATE. THEY AVOIDED REPLY TO QUESTIONS ON ACCEPTABILITY OF LARGE CURRENT SURPLUS OR WHAT COULD BE DONE ABOUT IT.
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